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June 14, 2004

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Room TWA-325
Washington, D.C. 20554

Re: Federal-State Joint Conference on Accounting Issues, WC Docket No. 02-269

Notice of Ex-Parte Communication

Dear Ms. Dortch:

On Thursday, June 10, 2004, Michelle Thomas and I, representing SBC; Mary Henze representing BellSouth; Margaret Cole representing Verizon and Cronan O'Connell representing Qwest met with Matthew Brill, Senior Legal Advisor to Commissioner Abernathy. The purpose of this meeting was to discuss the merits of each of the Federal-State Joint Conference on Accounting Issues proposed recommendations released on October 9, 2003. The attached documents were provided at the meeting.

In accordance with section 1.1206 of the Federal Communications Commission's rules, this letter is being filed in the above-referenced proceeding via the Commission's ECFS system.

Sincerely,

Attachment

Joint Conference Recommendations and Industry Response
June 10, 2004

Accounting and Reporting Issues

General Comments

- The Commission should continue streamlining the outdated accounting and reporting regulations and allow carriers more flexibility to transition to GAAP for regulatory reporting.
- The Commission may establish Part 32 accounting and ARMIS reporting rules to the extent such rules are necessary to the execution of the FCC's statutory responsibilities but it has no statutory authority to establish rules simply to assist states in applying the state law.
- In evaluating the Joint Conference's recommendations, the Commission should not lose sight of the fact that this proceeding began as a Section 11 biennial review to eliminate unnecessary accounting and reporting requirements rather than expanding regulatory requirements, as the Joint Conference proposes.

Joint Conference Recommendations and Industry Response

1. **Reinstate Account 5230 Directory Revenue**

   JCA Position: To separately monitor this line of business revenue.

   Response: There is no federal need for this data. Carriers can report Directory Revenue directly to the *few* states that require it. For example, at least one state requires reporting of Directory Revenue.

2. **Not consolidate Accounts 6621-Call Completion; 6622-Number services; and 6623-Customer Services into 6620-Services and create wholesale and retail sub-accounts**

   JCA Position: Reverse the FCC decision to consolidate accounts and create wholesale and retail sub-accounts.

   Response: There is no reason to disaggregate these accounts and the Commission should not require wholesale and retail sub-accounts. The JCA cited interest in support for UNE rate making, but also recognized that costs in accounts 6621 and 6622 are unrelated to UNEs. The states are amenable to an alternative, to report wholesale as a percent of Account 6623 on ARMIS reports (by state) instead of consolidating Accounts 6621 through 6623 and adding new sub-accounts. The wholesale amount representative of Account 6623 is not readily available using accounts or sub-accounts. Providing this data in ARMIS is not needed because everything that the states need to perform a UNE study is provided during the UNE proceedings.

3. **Not consolidate Accounts 6561 through 6565 Depreciation Expense into one Depreciation and Amortization Expense Account (6562)**

   JCA Position: The analysis of costs and determination of rate base sometimes differ between jurisdictions. As a result, segregation of the depreciation and amortization accounts continues to be needed by the states.

   Response: The FCC already recognized that there is no federal regulatory purpose that justifies maintaining these accounts. The states currently have separate authority over depreciation rates and methods. <u>The federal amounts reported in ARMIS cannot be used by states because states have their own depreciation lives and rates</u>. States can obtain this information from carriers in its state.

4. New Optical Switch Account

JCA Position: Use of an Optical Switching account will provide data regarding the extent of deployment of new technology.

Response: Implementation of new accounts is extremely burdensome and expensive. Carriers have no optical switches (maintenance is expensive and optical switching is not economically or technically viable in near term). The Commission should refrain from adding optical switch account and unnecessary reporting just to show $0. Several states as well as a member of the NLSG of Telcordia confirmed that no Optical Switches have been submitted for coding in the National Public Record Catalog. The National Public Record Catalog contains, along with certain engineering data, the classification criteria used by the PICS/DCPR system. (Plug In Control System/Detailed Continuing Property Record.

5. New Switching Software Account

JCA Position: There is substantial regulatory need for separate accounting for software investment. The magnitude of switching software warrants separate accounting.

Response: A new account solely for RBOCs only, is not necessary. The data, if necessary, can be obtained upon request from existing sources. Capitalized Switching Software information can be requested without the FCC establishing a new account.

6. New Loop and Interoffice Transport Accounts

JCA Position: Contract prices and model algorithms are inputs needed to determine compliance with TELRIC pricing standards.

Response: Impossible to directly record loop and interoffice in separate accounts and extremely burdensome for technician to report time to separate loop and interoffice accounts. Actual costs are not used for TELRIC pricing. Both loop and transport, including interoffice and local channel, sometimes ride the same cable and both may ride together on a single fiber strand within the cable. Part 32 records are kept by units of property, not by a fraction of a unit of property. See 47 CFR 32.2000(e)(1)(i)

7. New Interconnection Revenue Accounts with sub-accounts for UNEs, resale, reciprocal compensation and other interconnection arrangements

JCA Position: The FCC should revise the USOA to include these accounts. This data will be of value in assessing how the interconnection processes further the development of local competition and Form 477 does not collect comprehensive data on all interconnection activities.

Response: To implement what the JCA contemplates would require significant system and documentation changes for proposals the FCC has already considered and rejected. These accounts and sub-accounts would not serve a federal need and the information can be maintained without establishing new accounts. In addition, creation of accounts such as a resale account, in addition to burden related to the substantial cost in creating the accounts, would negatively impact the ability to properly follow Part 32 and Part 36 rules.

8. **New USF Accounts**

JCA Position: New USF accounts are needed to understand the federal USF programs and the effect these programs have on consumers because data of ILEC USF costs from FCC Form 499A is inadequate. JCA also stated USF receipts would be included in access revenue distorting access revenue data.

Response: The burden to create these accounts is not justified by a federal need. The proposed new accounts only impact the four RBOCs, but hundreds of companies contribute to USF. Federal State Joint Board already monitors and reports information relative to USF. Assessing effect on consumers cannot be accomplished by looking only at four RBOCS. Needed information should be collected by all USF participants, not just by the four RBOCs. In the Phase II Order, the Commission found adopting new accounts was unnecessary. Payments to the Federal Universal Service Fund today are journalized in Account 6540 Access Expense where separations directly assigns these costs.

9. Loop Sheath Kilometers

JCA Position: The JCA did comment that total Sheath Kilometer information is useful as it identifies the infrastructure for loop and interoffice combined.

Response: Change the “loop sheath kilometer” back to “sheath kilometers”
“Loop sheath Kilometers” should no longer be necessary. There is a huge financial burden on ILECs to implement because current systems do not disaggregate loop portion of the cable infrastructure.

10. Broadband infrastructure reporting

JCA Position: The JCA recommends the FCC deny the JPFR regarding the reporting of broadband infrastructure data in ARMIS Report 43-07.

Response: The FCC should not implement modifications to ARMIS 43-07 since it only applies to the four former RBOCs. Any changes to broadband reporting should cover the entire industry. The FCC should defer any action on broadband reporting to the industry-wide broadband reporting proceeding (DA 04-1555, WC 04-141).

11. The FCC should not agree with the “Dominant Vs. Non-Dominant” argument of SBC in its PFR.

JCA Position: Approval as proposed would provide incumbent LECs with an inappropriate opportunity to avoid the statutory and regulatory obligations.

Response: The Commission should reject the Joint Conference’s proposal that the Commission apply its accounting and reporting requirements to non-dominant ILECS.

In the *Phase 2 Order*, the Commission concluded that Section 32.11 of its rules should be amended to specifically apply only to ILECs on the ground that they are dominant in their markets. The Commission recognized that implementation of Part 32 is extremely burdensome and should not be imposed on non-dominant ILECS. However, in amending its rule, the Commission incorporated by reference the Section 251(h) definition of “incumbent local exchange carrier” into Rule 32.11. Section 251(h) however is inappropriate to determine which entities should be subject to the Commission’s accounting rules, because it provides no indication whether a particular entity is dominant in any market.

The fact that an ILEC affiliate might meet the definition of an "ILEC" under Section 251(h) says nothing about whether it is dominant in any relevant market. Thus, the Commission should not extend burdensome Part 32 accounting requirements to an ILEC affiliate simply because the ILEC transferred a service or asset to that affiliate. The Commission should adopt a structure that is similar to dominant carrier tariff filing requirements and "<u>clarify that the accounting rules apply only to ILECs who are dominant in their markets</u>."

Joint Conference on Accounting
Affiliate Transactions Recommendations

- FCC should not adopt Joint Conference on Accounting (JCA) recommendations to modify affiliate transactions rules
  - Recommendations would increase regulatory burden
  - Provide no benefit in a price cap environment
  - Phase II rule changes were conservative, fully considered; reduced burden

- FCC's affiliate transactions rules were established as a safeguard "to prevent cost shifting to ratepayers by means of improper transfer pricing"
  - Safeguard not necessary under price caps; no sharing or LFAM
  - Cost shifting no longer results in a corresponding increase in rates

- Under current rules, certain transactions between regulated company and affiliates must be valued at publically available rates or on an asymmetrical "comparison of fully distributed costs and fair market value."
  - Comparison is costly to perform
  - Designed to provide advantage to ILEC; not competitively neutral

- Joint Conference recommendations are internally inconsistent
  - Recognize that asymmetrical rules are anticompetitive
  - Yet seek to apply the rules more broadly

Specific Recommendations

1. $500,000 Exemption. *Recommends that the FCC maintain the relief provided in Phase II for first $500,000 of asset transfers.*

Everyone agrees rules for assets should match those for services.

2. Floor/Ceiling. "*The FCC should reverse its decision to permit ILECs to have discretion in valuing affiliate transactions as long as the valuation complies with a prescribed floor or ceiling.*"

A) *JCA Concern*: Rule change provides ILECs with "unfettered discretion" to price transactions.

B) *Response*: Joint Conference misunderstands the rule change; it does not provide the discretion they fear. Carriers are still required to perform the EFMV/FDC calculation and to base their transactions on those proscribed calculations. The rule continues to require the non-regulated affiliate to obtain fair market value and calculate costs in a proscribed manner. The rule change simply allowed the cost calculation for the services of a non-regulated affiliate to no longer rely on an ROR-based fully distributed cost methodology.

3. Prevailing Price Threshold. *"The FCC should reverse its decision to reduce the prevailing price threshold from 50% to 25%."*

A) *JCA Concern*: ILECs will take advantage of this change to intentionally under price 25% of their sales to outside parties just so affiliate will benefit and/or their own earnings will be depressed.

B) *Response*: This fear is unfounded in a price cap environment; no rational company would behave in this fashion. The rule change simply recognizes that 25% of sales to willing third-party buyers clearly establishes a "fair market value." The rule change actually subjects fewer transactions to the EFMV/FDC comparison which is consistent with the JCA's concern that asymmetrical rule is anticompetitive because it always advantages the ILEC.

4. Centralized Services. *"The FCC should eliminate the centralized services exemption."*

A) *JCA Concern*: That the centralized services exemption allows the carrier to pay in excess of market prices for services from affiliates and thus inflate costs and depress earnings.

B) *Response*: This concern is unfounded in a price cap environment. The FCC allowed for limited exemption from EFMV/FDC comparison so that carriers would benefit from the economies of scope and scale associated with centralized services organizations. Virtually all of the services performed by such organizations are NOT available from outside sources and thus there is no market price to use for comparison. Eliminating the exemption would require significantly more transactions to be subject to the asymmetrical rule (which the JCA believes is anticompetitive). ILEC costs would increase significantly due to need to develop market prices to use in comparison.

5. Intra-company transfers. *Recommends that transactions between ILECs in the same holding company be subject to affiliate transactions rules.*

A) *JCA Concern:* Without rules, costs will be manipulated and earnings depressed.

B) *Response:* Concern is unfounded in price cap environment. Rate of return states have their own methods of reviewing affiliate transactions in rate case proceedings. In addition, asymmetrical rules cannot be applied since both parties are ILECs.

6. Nonreg/Nonreg. *Recommends that the FCC maintain current rules that require transactions between non-regulated affiliates and the ILEC's non- regulated operations to be subject to affiliate transactions rules.*

Response: Rule is not necessary in a price cap environment, however, ILECs have not proposed that it be deleted since FCC denied initial request in Phase II Order.